

SE DELTA UNIT AGREEMENT

FINDINGS AND DECISION OF THE COMMISSIONER

STATE OF ALASKA

DEPARTMENT OF NATURAL RESOURCES

March 29, 2001

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## **I. INTRODUCTION AND BACKGROUND**

On December 11, 2000, Phillips Alaska, Inc. (“Phillips”) applied for approval of the proposed Unit Agreement (“Agreement”). The proposed SE Delta Unit is on the North Slope, east of the Colville River and west of the Kuparuk River Unit. The proposed unit area covers approximately 31,802 acres within seven individual State of Alaska oil and gas leases. Phillips submitted the SE Delta Unit application for approval by the State of Alaska, Department of Natural Resources (“DNR”). Approval of the Agreement would conform and modify the lease contracts.

Five of the leases in the proposed unit area were offered in State of Alaska Lease Sale 70A, held on January 29, 1991. DNR issued oil and gas leases ADL 375067, ADL 375068, ADL 375070, ADL 375071 and ADL 375072 effective April 1, 1991, on State of Alaska lease form number DNR 10-4037 (revised 9/90). The ten-year primary lease term of these five leases expires on March 31, 2001. DNR offered oil and gas lease ADL 389056 in State of Alaska Lease Sale 87, held on June 24, 1998. DNR issued ADL 389056 effective November 1, 1998, on State of Alaska lease form number DOG 9609 (revised 6/97) which provides for a seven-year primary term. Oil and gas lease ADL 389161 was offered in State of Alaska Areawide Lease Sale NS1999, held on February 24, 1999. DNR issued ADL 389161 effective July 1, 1999, on State of Alaska lease form number DOG 9609 (revised 2/99) which provides for a seven-year primary term. All seven leases retain a 12.5 percent royalty to the State of Alaska. Arco Alaska, Inc. was the initial owner of all seven leases. The Agreement, if approved, will extend the term of the state leases for as long as they are subject to the Agreement. 11 AAC 83.190.

Phillips is the proposed unit operator and holds 100% working interest in the proposed unit area. Phillips Petroleum Company acquired Arco Alaska, Inc. and changed the company name to Phillips Alaska, Inc. effective April 27, 2000.

## **II. APPLICATION FOR THE FORMATION OF THE SE DELTA UNIT**

A.S. 38.05.180(p) gives DNR the authority to form an oil and gas unit. Phillips submitted the SE Delta Unit application (the Application) on December 11, 2000, and paid the \$5000.00 unit application filing fee on December 12, 2000, in accordance with 11 AAC 83.306 and 11 AAC 05.010 (a)(10)(D) respectively. The Application includes the Agreement with Exhibit A describing the proposed unit area, Exhibit B depicting the proposed unit boundary, and Exhibit G the First Plan of Exploration; the SE Delta Unit Operating Agreement; technical data in support of the Application; and an affidavit that all proper parties were invited to join the Agreement. The Agreement is based on DNR’s State Only Royalty Owner model unit form dated November 2000 (Model Form). DNR and Phillips proposed various amendments to the Model Form and the Application includes a detailed list of the proposed changes to the Model Form. Specific changes to the Model Form are discussed in Section IV below.

The proposed Agreement requires the Unit Operator to file unit plans describing the activities within the proposed unit area. The Unit Operator must consider how they can best develop the resource underlying the entire unit area, without regard to internal lease boundaries. Phillips filed a two-year Initial Unit Plan that meets the state's requirement for a Plan of Exploration. 11 AAC 83.341. The Initial Unit Plan identifies two prospects within the unit area, Atlas and Cronus, and includes a commitment to complete drilling operations on the Atlas Well before June 1, 2001 and the Cronus Well by June 1, 2002. The Initial Unit Plan is discussed further in Section III b) 4.

DNR determined that the SE Delta Unit application was complete and published a public notice in the "*Anchorage Daily News*" on Sunday, December 17, 2000, and in the "*Arctic Sounder*" on Thursday, December 21, 2000, pursuant to 11 AAC 83.311. DNR provided copies of the public notice to the North Slope Borough ("NSB"), the City of Barrow, the City of Nuiqsut, Arctic Slope Regional Corporation, Kuukpiik Corporation and other interested parties in conformance with 11 AAC 83.311. DNR also provided public notice to the Alaska Department of Environmental Conservation ("ADEC"), Alaska Department of Fish and Game ("ADF&G"), and the Alaska Oil and Gas Conservation Commission ("AOGCC").

The public notice invited interested parties and members of the public to submit comments by February 5, 2001. The Division received no comments in response to the public notice.

The Agreement defines the relationship between the unit operator, the working interest owner, and the royalty owner. It describes the rights and responsibilities, in addition to those imposed by state law and the leases, of the unit operator, working interest owner and royalty owner for exploration and development of the unit area. It protects the interests of the state and the lessee. It defines the parties' rights and responsibilities in the event of successful or unsuccessful exploration results. DNR may approve the Agreement if the available data suggests that the unit area covers one or more geologic formations that should be developed under a consistent plan and the proposed unit meets the other statutory and regulatory criteria.

### **III. DISCUSSION OF DECISION CRITERIA AND FACTORS CONSIDERED**

#### **a.) Decision Criteria**

The DNR Commissioner reviews unit applications under AS 38.05.180(p) and 11 AAC 83.301 et. seq. The Commissioner will approve the proposed Agreement upon a written finding that it will: 1) promote the conservation of all natural resources; 2) promote the prevention of economic and physical waste; and 3) provide for the protection of all parties of interest, including the state. 11 AAC 83.303(a). The following evaluates the proposed SE Delta Unit under these criteria.

## **1. The Conservation of All Natural Resources**

DNR recognizes unitization of the leases overlaying a reservoir as a prudent conservation mechanism. Without unitization, the unregulated development of reservoirs can become a race for possession by competitive operators. The results can be: 1) unnecessarily dense drilling, especially along property lines; 2) rapid dissipation of reservoir pressure; and 3) irregular advance of displaced fluids, all of which contribute to the loss of ultimate recovery or economic waste. The proliferation of surface activity; duplication of production, gathering, and processing facilities; and haste to get oil to the surface also increase the likelihood of environmental damage. Requiring lessees to comply with conservation orders and field rules issued by the AOGCC would mitigate some of these impacts without an agreement to unitize operations. Unitization, however, provides a practical and efficient method for maximizing oil and gas recovery, while minimizing negative impacts on other resources.

The concern of lessees competing for the oil and gas, if discovered, is not evident in the proposed SE Delta Unit where Phillips is only lessee. However, Phillips may assign a portion of its interest to others before the unit terminates. Even with only one working interest owner, formation of the unit will provide the state with a comprehensive plan for exploring and developing the entire unit area. Formation of the SE Delta Unit and approval of the Initial Unit Plan will ensure that Phillips prudently explores and develops both prospects identified in that plan.

The Agreement will promote the conservation of both surface and subsurface resources through unitized (rather than lease-by-lease) development. Unitization allows the unit operator to explore the area as if it were one lease. Without the Agreement the lessee would be compelled to seek permits to drill wells on each individual lease in order to extend the leases beyond their primary term. Unitization reduces both the number of facilities required to develop reserves that may be discovered and the area of land required to accommodate those facilities. Review and approval of exploration and development permits under a unit agreement will also assure that rational surface-use decisions are made without consideration of individual lease ownership or expense. As a result, facilities can be located to maximize recovery and to minimize environmental impacts, without regard to issues of ownership or operation of individual leases. Although Phillips has not determined the extent of any oil and gas contained in the prospective reservoirs, the Agreement will ensure exploration and maximize recovery from the leases if Phillips discovers a commercial hydrocarbon accumulation.

## **2. The Prevention of Economic and Physical Waste**

Formation of the unit will prevent economic and physical waste because the unit operator must have an equitable cost sharing formula and a coordinated development plan. An equitable cost-sharing agreement promotes efficient development of common surface facilities and operating strategies. An equitable cost-sharing agreement, and an acceptable unit operator, allows the working interest owners in the unit to rationally decide well spacing requirements, injection strategies, and the proper joint-use of surface facilities. Unitization prevents economic and physical waste by eliminating redundant

expenditures for a given level of production, and by avoiding loss of ultimate recovery by adopting a unified reservoir management plan.

Unitized operations greatly improve development of reservoirs beneath leases that may have variable productivity. Marginally economic reserves, which otherwise would not be produced on a lease-by-lease basis, often can be produced through unitized operations in combination with more productive leases. Facility consolidation and facility sharing save capital and promotes better reservoir management for all working interest owners. Pressure maintenance and secondary recovery procedures are much more predictable and attainable through joint, unitized efforts than would otherwise be possible. In combination, these factors allow less profitable areas of a reservoir to be developed and produced in the interest of all parties, including the state.

The overall costs of exploring and developing the SE Delta Unit leases would be higher on a lease-by-lease basis than it will be under the terms of unitization. Investments in drilling and facilities costs will be minimized as a consequence of eliminating the requirement for duplicate facilities on individual leases. Locations of individual wells and surface facilities will be selected to optimize recovery of the resources and to minimize costs with due regard for environmental considerations.

Reducing costs through unitized operations will expedite development of any reserves discovered and will promote greater ultimate recovery of any oil and gas in the unit area. This will accelerate and extend the state's income stream from severance taxes and royalties, and provide employment for Alaskans. The production revenues to the lessee may be reinvested in new exploration and development in the state.

### **3. The Protection of All Parties in Interest, Including the State**

The proposed formation of the SE Delta Unit seeks to protect the economic interests of the working interest owners as well as the royalty owner. Combining interests and operating under the terms of the Agreement and SE Delta Unit Operating Agreement assures each individual working interest owner an equitable allocation of costs and revenues commensurate with the value of its lease(s).

The proposed Agreement promotes the state's economic interests because exploration will likely occur earlier than without unitization. Diligent exploration under a single approved unit plan without the complications of competing operators is certainly in the state's best interest. It promotes efficient evaluation of the state's resources, while minimizing impacts to the region's cultural, biological, and environmental resources. If Phillips makes a commercial discovery it will stimulate the state's economy from the production-based revenue, oil and gas related jobs, and service industry activity.

The Agreement provides for accurate reporting and record keeping, state approval of operating procedures, in-kind taking, and emergency storage of oil, all of which will further the state's interest.

## **b.) Factors Considered**

State regulations require the Commissioner to consider the following six factors in evaluating a unit application: (1) the environmental costs and benefits of unitized exploration or development; (2) the geological and engineering characteristics of the potential hydrocarbon accumulation or reservoir proposed for unitization; (3) prior exploration activities in the proposed unit area; (4) the applicant's plans for exploration or development of the unit area; (5) the economic costs and benefits to the state; and (6) any other relevant factors, including measures to mitigate impacts identified above, the Commissioner determines necessary or advisable to protect the public interest. 11 AAC 83.303(b). A discussion of each factor, as it applies to the proposed Agreement, is provided below.

### **1. The Environmental Costs and Benefits of Unitized Exploration or Development**

DNR develops lease stipulations through the lease sale process to mitigate the potential environmental impacts. Alaska Statutes require DNR to give public notice and issue a written finding before the disposal of the state's oil and gas resources. AS 38.05.035(e), AS 38.05.945, and 11 AAC 82.415.

Five of the seven leases in the proposed unit area were offered in State of Alaska Lease Sale 70A, held on January 29, 1991; one was offered in State of Alaska Lease Sale 87, held on June 24, 1998; and one was offered in State of Alaska Areawide Lease Sale NS1999, held on February 24, 1999. DNR considered all comments filed before holding Sale 70A, 87 and NS1999 and included lease stipulations in the Final Findings to address them. Lease stipulations and mitigation measures, developed by DNR during the lease sale process, are attached to and incorporated in the individual lease contracts. These stipulations require Phillips to take mitigation measures to protect the environment. The lease stipulations and mitigation measures address the protection of primary waterfowl areas, access to subsistence resources, site restoration, construction of pipelines, seasonal restrictions on operations, and avoidance of seismic hazards, among other things.

State regulation 11 AAC 83.303 (b)(1) requires that the Commissioner assess the environmental costs and benefits of the proposed SE Delta Unit. Phillips' Initial Unit Plan describes two exploratory wells, the Atlas and Cronus Wells, to be drilled as winter operations from ice pads. DNR's approval of an Initial Unit Plan is only one step in the process of obtaining permission to build ice pads and drill wells to explore the unit area. The unit operator must obtain DNR's approval of a unit plan of operations and permits from various state and federal agencies before beginning operations within the unit area.

State unitization regulations require the Commissioner's approval of a unit plan of operations before the unit operator performs any field operations. 11 AAC 83.346. A unit plan of operations provides a more detailed plan for surface activities incident to exploration of the unit area than does the Initial Unit Plan. DNR's consideration of environmental issues is part of both the lease sale process and the review of a unit plan of operations. The leases in the proposed SE Delta Unit area include over thirty stipulations/mitigation measures. The Agreement does not weaken the mitigation measures imposed as lease terms. DNR will review the lease stipulations with respect to a proposed unit plan of operations

to ensure that they mitigate adverse environmental impacts to the SE Delta Unit area. In addition to protection measures adopted for the lease sale, the Commissioner may impose additional conditions or limitations beyond those imposed by law. AS 38.05.035(e). If the SE Delta Unit is expanded to include newer state leases, the mitigation measures attached to those newer leases may be extended to activities on any state lease in the unit area.

On October 24, 2000, Phillips began the permitting process to commence operations under the Initial Unit Plan by submitting a Coastal Project Questionnaire and consistency certification, applications, and supporting information to DGC to determine if the proposed Atlas #1 and Atlas #2 wells were consistent with the Alaska Coastal Management Program (ACMP) and the NSB Coastal District Plan (CDP). Submittal of these documents to the state initiated a public and agency review process. DGC organized the inter-agency review, determined which permits were required, and published a public notice soliciting comments from federal, state and local agencies on Phillips' proposed plan of operations. Phillips planned to construct two ice pads within the proposed unit area and drill up to five penetrations, two wells and three sidetracks. DGC designated a 50-day review schedule starting with a public notice on November 8, 2000. The agencies were asked to review the application, request any additional information by December 4, 2000, and submit comments by December 11, 2000, so that DGC could issue a Proposed Consistency Determination by December 21, 2000 and the Final Consistency Determination on or before December 27, 2000. DNR's Division of Mining, Land & Water (DML&W) issued a land use permit to authorize ice roads associated with the Atlas Well. DML&W found that with additional stipulations concerning the operation of vehicles, disposal of solid waste and debris, and containment of fuel and hazardous substances, the project was consistent with the standards of the ACMP and the CDP. On December 4, 2000, DEC submitted a 17-page request for additional information and DGC suspended the review period pending a response from Phillips. On December 7, 2000, DNR's Division of Oil and Gas concurred with DML&W's recommended stipulations and found the Plan of Operations to be consistent with the ACMP and the CDP. ADF&G also found the Plan of Operations consistent with the ACMP and the CDP and prepared Title 16 fish Habitat Permits for water withdrawal from local lakes, to be issued upon issuance of the final consistency determination. DEC notified DGC that the information was complete on December 28, 2000, and DGC restarted the review process with the following schedule: 1) comment deadline January 8, 2001, 2) Proposed Determination by January 16, 2001, and 3) Final Determination issued by January 23, 2001. When the state resource agencies and the NSB determined that the proposed plan of operations was consistent with the ACMP and NSBCMP and DGC was satisfied that all permits and authorizations were in order, they issued the final ACMP Consistency Determination on January 23, 2001. In addition to the permits and plans discussed above, Phillips also needed drilling permits from AOGCC. AOGCC issued a drilling permit for the Atlas #1 well on February 15, 2001. Phillips completed construction of the ice pads and began drilling the Atlas #1 Well on February 1, 2001.

Phillips submitted the Cronus #1 well Coastal Project Questionnaire and supplemental applications to the Natural Resource agencies on February 22, 2001. Phillips plans to drill up to three penetrations, one well and two sidetracks. On February 10, 2001, DGC set the review schedule for the Cronus #1 well application: March 15, 2001 comment deadline, proposed determination by March 27, 2001, and the Final ACMP Determination by April 3, 2001.



When reviewing a proposed unit plan of operations, the Division will also consider the unit operator's ability to compensate the surface owner for damage sustained to the surface estate and the plans for rehabilitation of the unit area. In addition, DNR, DEC, and AOGCC also have bonding and financial responsibility requirements to ensure performance by the operator and reclamation of the area. 11 AAC 96.060, 20 AAC 25.025, and 18 AAC 75.235.

Any new construction or exploration activity that may occur following unitization, unless categorically approved in the ACMP ABC (General Concurrence) list, is subject to a coastal zone consistency determination, and must comply with both the state and NSB coastal zone management plans. These amendments and additions to a unit plan of operations require the same public notice and agency review through the DGC as the plan of operations described above. DGC determines the intensity of the review process on a case-by-case basis. Ongoing activities such as development drilling, snow plowing, road grading and material storage at an approved site are not subject to the Coastal Zone Management review process.

The proposed SE Delta Unit area is habitat for a variety of mammals, waterfowl and fish. Area residents use this area for subsistence hunting and fishing. Oil and gas activity in the proposed unit area may impact some wildlife habitat and some subsistence activity. Ongoing mitigation measures such as seasonal restrictions on specific activities in certain areas can reduce the impact on bird, fish, and mammal populations. Designating primary waterfowl areas is one method of protecting bird habitat. DNR can require consolidation of facilities to minimize surface disturbances. The regulation of waste disposal is another way to limit environmental impacts. With these and other mitigating measures in addition to existing oil and gas laws, the anticipated exploration and development related activity is not likely to significantly impact bird, fish, and mammal populations. The environmental impact will depend on the level of exploration activity, the effectiveness of mitigation measures, the size and location of facilities, and the availability of alternative habitat and subsistence areas. In any case, the anticipated activity under the Agreement will impact habitat and subsistence activity less than if the lessees explored and developed the leases individually.

The act of unitization in itself has no environmental impact. Unitization does not entail any environmental costs beyond those that may occur as a result of issuing the permits necessary to conduct lease-by-lease exploration or development. In addition, unitized exploration, development and production minimize surface impacts by consolidating facilities and reducing activity in the field. The Commissioner's approval of a unit agreement is an administrative action, which by itself does not convey any authority to conduct any operations on the leases within the unit. Unitization does not waive or reduce the effectiveness of the mitigating measures that condition the lessee's right to conduct operations on these leases.

## **2. Prior Exploration Activities in the SE Delta Unit Area**

The proposed SE Delta Unit is located on the North Slope adjacent to the southwest corner of the Kuparuk River Unit (KRU). The Kuparuk River Field was first discovered in 1969 and began

production from the Early Cretaceous Kuparuk River Formation in 1981. Subsequent satellite discoveries were made in the KRU with Tarn (1997) and Meltwater (2000) both from productive intervals in the late Cretaceous. The Tarn accumulation, centered approximately 4 miles northeast of Atlas, commenced production in 1998. The Meltwater accumulation is situated approximately 3 miles east of Cronus. Approximately 16 miles to the northwest is the Colville River Unit, which discovered oil in the Jurassic Kingak Formation (Alpine Field) in 1994, and came on production in 2000. The nearest well control to Atlas and Cronus are the Arco Cirque #2, ARCO Tarn #1, ARCO Tarn #2 and ARCO Bermuda #1 wells to the east and the BP Itkillik #1 well located west of Atlas. While these wells were drilled to prove up the potential of different stratigraphic horizons, all penetrated the Torok Formation, the late Cretaceous primary objective at Atlas/Cronus. The Torok, however, manifested itself in all cases as non-reservoir facies.

### **3. The Geological and Engineering Characteristics of the Reservoir**

The State's regulations necessitate that a unit must encompass the minimum area required to include all or part of one or more oil or gas reservoirs, or potential accumulations. 11 AAC 83.356(a). DNR technical staff evaluated all data provided by the unit operator to determine if the proposed unit area met that criterion. The data provided included interpreted seismic data and other geologic displays. The data are confidential and therefore are not discussed in detail here.

The State's evaluation of the subsurface geology supports the configuration of the unit area as proposed. The operator identified two legitimate geologic prospects (Atlas and Cronus) that may occur in the Early Cretaceous Torok Formation. The initial well in the Atlas prospect will be drilled to a depth sufficient to penetrate the Torok Formation or 6200 feet (true vertical depth), whichever is less. DNR's review of the geologic information supports the inclusion of all leases identified in the unit application within the proposed unit area.

### **4. The Applicant's Plans for Exploration and Development of the Proposed SE Delta Unit Area**

In the application to form the SE Delta Unit Phillips proposed an Initial Unit Plan of Exploration (Initial POE) that expires on June 1, 2003. The Initial POE includes plans to drill an exploration well in each of the two identified prospects, with the following requirements: Phillips must 1) complete drilling operations on the Atlas Well by June 1, 2001; 2) commit in writing to drill the Cronus Well by June 1, 2001; and 3) drill the Cronus Well to completion by June 1, 2002.

Completion of these exploration activities as scheduled will satisfy the performance standards and diligence requirements that the state and Phillips agreed to as a condition for approval of the Agreement. If Phillips fails to drill the Atlas Well to completion as scheduled, the Initial POE will be in default, the Agreement will terminate, and the working interest owners will surrender the acreage in the unit area that is past its primary term. If Phillips completes the Atlas well as scheduled but fails to commit to drill the

Cronus well by June 1, 2001, the Cronus Leases will contract out of the SE Delta Unit and the working interest owners will surrender the Cronus Lease acreage that is past its primary term. If Phillips completes the Atlas Well as scheduled and commits to drill the Cronus Well but fails to drill the Cronus Well to completion as scheduled, 1) the Cronus Leases will contract out of the SE Delta Unit, 2) the working interest owners will surrender the Cronus Lease acreage that is past its primary term and 3) they will pay the State of Alaska \$300,000 by July 1, 2002. If Phillips drills both the Atlas and Cronus Wells as scheduled, the term of the Initial POE may be extended another year by drilling an additional well or sidetrack in the Unit Area. The additional well or sidetrack must be completed by June 1, 2003, to extend the term of the Initial POE until June 1, 2004. These provisions ensure that the lease extensions resulting from unitization pursuant to 11 AAC 83.336(a)(2) continue only so long as Phillips proceeds diligently with exploration and development.

Phillips must report annually on its progress under the plan, and submit another unit plan, for further exploration or development of the unit area, at least 90 days before the Initial POE expires. Although the regulation requires a new plan of exploration at least 60 days before the expiration date of the previously approved plan, the Initial POE provides for submittal of a second Plan of Exploration for the SE Delta Unit 90 days before the Initial POE expires. 11 AAC 83.341 (b).

Unitization provides a comprehensive plan for exploration of the unit area. Phillips' Initial POE allows for earlier exploration and confirmation of the prospect in the SE Delta Unit area than would occur under the individual leases.

## **5. The Economic Costs and Benefits to the State and Other Relevant Factors**

Approval of the Agreement will result in both short term and long term economic benefits to the State. The assessment of the hydrocarbon potential of the subject leases will create jobs in the short term. If Phillips makes a commercial discovery, the state will earn royalty and tax revenues in the long term.

Some of the leases in the proposed unit area will expire on March 31, 2001, if they are not extended by unitization. If the leases expire, the leasehold interest will return to the state. The earliest that DNR could re-offer the land, under the current Five-Year Oil and Gas Lease Sale Schedule, is November 2001. There is no certainty that anyone would bid on the tracts or pursue exploration of this speculative area. If DNR leased the tracts again in 2001, the state would receive bonus payments and rentals for the primary term of the new leases. However, it could be years before the new lessees would propose exploration of the area. Under the proposed Agreement, the unit operator commits to drill the Atlas Well this year and make a commitment to drill the Cronus Well by June 1, 2001. These commitments provide the state with the opportunity to receive royalties from the leases sooner than if the acreage was re-offered.

If by June 1, 2001, Phillips has completed drilling the Atlas Well and commits to drill the Cronus Well, the Cronus Lease acreage will not be available for lease in the North Slope 2001 Areawide Lease Sale. If after committing to drill the Cronus Well, Phillips fails to drill the well to completion by June 1, 2002,

the Cronus Lease acreage will then be available for re-offer in the North Slope 2002 Areawide Lease Sale, however, the state will have lost the opportunity to receive bonus bids on the acreage in the previous sale. Therefore, the Initial POE imposes a \$300,000 financial penalty if Phillips fails to drill the Cronus Well after committing to do so. Phillips agreed to compensate the state for extending the lease terms and foregoing the bonus bids and interest the state could have earned if the acreage was offered in the North Slope 2001 or North Slope 2002 Areawide lease sales. Imposing this penalty protects the state from the potential loss of interest on foregone bonus payments due to withholding the 10,000 acres from leasing for one year. If Phillips commits to drill the Cronus Well by June 1, 2001, and successfully completes the Cronus Well by June 1, 2002, as scheduled the additional financial penalty will not be due.

If Phillips does not continue to explore and develop the unit area, the Agreement will terminate and leases will return to the state. The potential long-term economic benefit of exploration and earlier development of the SE Delta Unit area outweighs the short-term loss of potential bonus payments. Annual rental payments are high for most of the leases in the unit because the leases are near the end of their primary term. The state receives a 12.5% royalty share from the leases unit area.

#### **IV. AMENDMENTS TO THE MODEL UNIT AGREEMENT FORM**

The proposed SE Delta Unit Agreement is based on the State Only Royalty Owner Unit Agreement, revised November 2000 (Model Form). Phillips and the State requested changes in the Model Form during the development of the Agreement. In Article 1, Definitions, a definition for Lease or Leases was added and the definition of Unitized Substances was changed to coincide with lease language. The information displayed on unit exhibits was clarified in Article 2, Exhibits. Article 3.2 was reworded to clarify that the leases remain in effect as long as the unit is in effect and Article 3.7 was revised so that the Unit Operator is required to notify the other Working Interest Owners of actions undertaken, but not "all" actions undertaken. Article 9.1 was reworded to conform to the regulations. Article 10.1 was added; it is similar to lease language on offset wells. Article 11.4 was revised to clarify when the Working Interest Owners pay royalty on flared gas. Article 12.4 was revised to indicate that the royalty share would bear it proportionate share of any shrinkage that may occur during blending. Article 13.2 was deleted to avoid any conflicts with the regulations and the remaining sections of Article 13 were renumbered. Article 14 was revised to reflect that the Unit Plan may contain some terms and conditions that effect the termination of the Unit. All of the proposed changes to the model unit agreement are acceptable to the state.

## **V. FINDINGS AND DECISION**

### **a.) The Conservation of All Natural Resources.**

1. The Agreement will conserve all natural resources, including hydrocarbons, gravel, sand, water, wetlands, and other valuable habitat.
2. The unitized development and operation of the leases in this proposed unit will reduce the amount of land and fish and wildlife habitat that would otherwise be disrupted by individual lease development. This reduction in environmental impacts and preservation of subsistence access is in the public interest.
3. If the exploration activities in the Initial Unit Plan result in the discovery of a commercially producible reservoir, then there will be environmental impacts associated with the reservoir development. All unit development must proceed according to an approved plan of development. Before undertaking any specific operations, the unit operator must submit a unit plan of operations to the Division and other appropriate state and local agencies for review and approval. The lessees may not commence drilling or development operations until all agencies have granted the required permits. DNR may condition its approval of a unit plan of operations and other permits on performance of mitigating measures in addition to those in the leases if necessary or appropriate. Requiring strict adherence to the mitigating measures will minimize adverse environmental impacts.

### **b.) The Prevention of Economic and Physical Waste.**

1. Phillips submitted geological and engineering data to DNR in support of the unit application. Division technical staff determined that the SE Delta Unit area encompasses all or part of one or more potential hydrocarbon accumulations. The available geologic and engineering data justify including the proposed lands, described in Exhibit A, in the SE Delta Unit.
2. The Initial Unit Plan meets the requirements of 11 AAC 83.303 and 11 AAC 83.341. The unit operator must conduct the proposed exploration activities in accordance with the timelines specified in the plan. The Initial Unit Plan describes the performance standards and diligence requirements to which the state and Phillips have agreed. If the working interest owners fail to perform any of the exploration activities outlined in the Initial Unit Plan as scheduled, the plan will be in default and the Agreement will terminate or the unit will contract.
3. Phillips must submit an annual update to the Initial Unit Plan to DNR for approval. 11 AAC 83.341. The annual update must describe the status of projects undertaken and the work completed, as well as any proposed changes to the plan. Any changes to the Initial Unit Plan, in order to be approved by the state, must comply with Article 8 of the Agreement.

Phillips must submit a new exploration or development plan 90 days before the initial plan expires.

4. Phillips's Initial Unit Plan provides for the rational exploration of potential hydrocarbon accumulations in the unit area. If Phillips discovers oil or gas in commercial quantities, the Agreement will prevent the waste of oil and gas, and increase the probability of recovering more hydrocarbons from the unit area. DNR must approve a plan of development before Phillips produces any hydrocarbons in commercial quantities.
5. The SE Delta Unit will expedite exploration and potential development of the unit area. With the formation of the SE Delta Unit, economic benefits to the state far outweigh the economic costs of extending the primary term of the state leases committed to the unit.

**c.) The Protection of All Parties in Interest, Including the State.**

1. The Agreement, conditioned upon the performance of its Initial Unit Plan, adequately and equitably protects the public interest, and is in the state's best interest.
2. The Agreement meets the requirements of AS 38.05.180(p) and 11 AAC 83.303.
3. DNR complied with the public notice requirements of 11 AAC 83.311.
4. The Agreement will not diminish access to public and navigable waters beyond those limitations (if any) imposed by law or already contained in the oil and gas leases covered by this Agreement.
5. The Agreement provides for expansions and contractions of the unit area in the future, as warranted by data obtained by exploration. The Agreement thereby protects the public interest, the rights of the parties, and the correlative rights of adjacent landowners.

For the reasons discussed in this Findings and Decision, I hereby approve the SE Delta Unit Agreement. Under Article 14.1 of the Agreement, it shall become binding upon each party as of the date each party signs the instrument by which it becomes a party. The Agreement shall become effective as of 12:01 a.m. on the day following approval by the Commissioner.

A person adversely affected by this decision may request reconsideration of this decision, in accordance with 11 AAC 02, to Pat Pourchot, Commissioner, Department of Natural Resources, 550 W. 7th Avenue, Suite 1400, Anchorage, Alaska 99501-3561. Any request for reconsideration must be received at the above address, or by fax to 1-907-269-8918, within 20 calendar days after the date of "delivery" of this decision, as defined in 11 AAC 02.040. A copy of 11 AAC 02 may be obtained from any regional information office of the Department of Natural Resources.

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Pat Pourchot, Commissioner  
Alaska Department of Natural Resources

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Date




Appeal Code: OGO032901SEDUNIT


Attachments: Exhibit A, Unit Tract Schedule  
Exhibit B, Map of the Unit Boundary

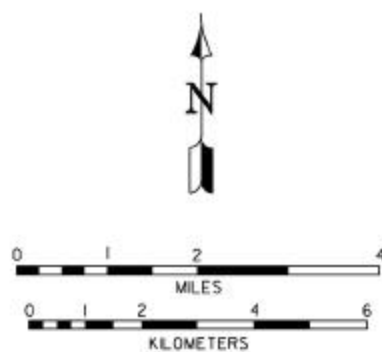
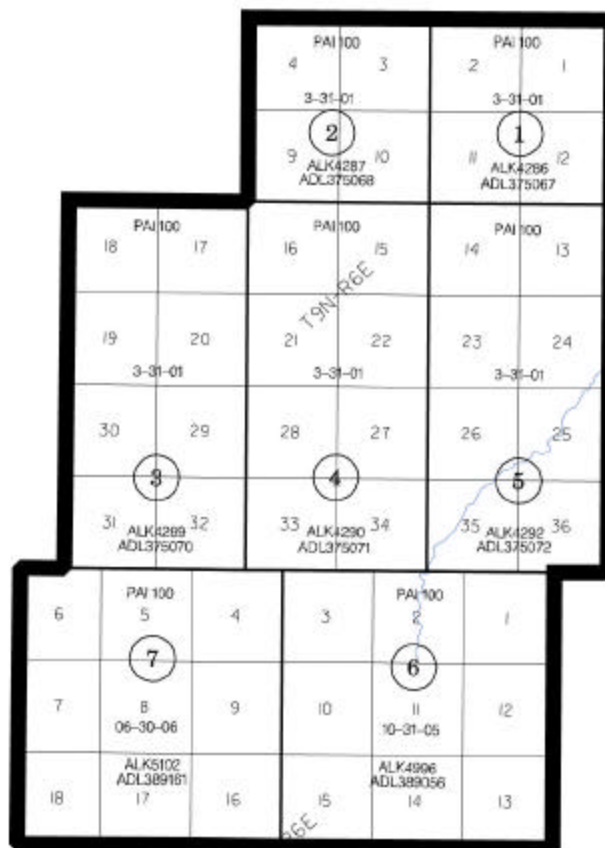
**EXHIBIT "A"****SE DELTA UNIT AGREEMENT**

<b>Tract No. (PAI No.)</b>	<b>State No. Eff-Exp Date</b>	<b>Legal Description</b>	<b>WI Owners</b>	<b>Burdens</b>
Tract No. 1 (ALK-4286)	ADL-375067 Effective 04/01/1991 Expiring 03/31/2001	T9N-R6E, U.M. Sec. 1, 2, 11 & 12 Containing 2,560.00 acres	PAI 100.00%	State 12.5%
Tract No. 2 (ALK-4287)	ADL-375068 Effective 04/01/1991 Expiring 03/31/2001	T9N-R6E, U.M. Sec. 3, 4, 9 & 10 Containing 2,560.00 acres	PAI 100.00%	State 12.5%
Tract No. 3 (ALK-4289)	ADL-375070 Effective 04/01/1991 Expiring 03/31/2001	T9N-R6E, U.M. Sec. 17, 18, 19, 20, 29, 30, 31 & 32 Containing 5,099.00 acres	PAI 100.00%	State 12.5%
Tract No. 4 (ALK-4290)	ADL-375071 Effective 04/01/1991 Expiring 03/31/2001	T9N-R6E, U.M. Sec. 15, 16, 21, 22, 27, 28, 33 & 34 Containing 5,120.00 acres	PAI 100.00%	State 12.5%
Tract No. 5 (ALK-4292)	ADL-375072 Effective 04/01/1991 Expiring 03/31/2001	T9N-R6E, U.M. Sec. 13, 14, 23, 24, 25, 26, 35 & 36 Containing 5,120.00 acres	PAI 100.00%	State 12.5%
Tract No. 6 (ALK-4996)	ADL-389056 Effective 11/01/1998 Expiring 10/31/2005	T8N-R6E, U.M. Sec. 1, 2, 3, 10, 11, 12, 13, 14 & 15 Containing 5,760.00 acres	PAI 100.00%	State 12.5%
Tract No. 7 (ALK-5102)	ADL-389161 Effective 07/01/1999 Expiring 06/30/2006	T8N-R6E, U.M. Sec. 4, 5, 6, 7, 8, 9, 16, 17 & 18 Containing 5,583.00 acres	PAI 100.00%	State 12.5%



-  Unit Boundary
-  Lease Boundary
-  Section Line

 Tract Number



 **PHILLIPS Alaska, Inc.**  
A Subsidiary of PHILLIPS PETROLEUM COMPANY

Exhibit B

# SE Delta Unit Agreement